



## **California budget mess brings Schwarzenegger full circle**

By Aaron C. Davis

January 5, 2008

Gov. Arnold Schwarzenegger will declare a fiscal emergency this week and release his blueprint for closing an estimated \$14 billion budget deficit, a gap so large that cuts to schools, health care and welfare programs appear inevitable.

It's an uncomfortable *deja vu* for the governor, who rode into office in 2003 facing a similarly sized shortfall and promising to fix the state's budget roller coaster once and for all.

California's reliance on volatile sources of tax revenue, as well as voter-approved ballot measures that dictate state spending, have helped create the problem. But so have some decisions that Schwarzenegger has made along the way.

Economists say that despite Schwarzenegger's pledge of fiscal prudence, he has just barely kept the state's budget balanced. He has done little, they say, to rein in government growth and insulate the state from the ups and downs of the markets the way most other states have.

Instead, Schwarzenegger has allowed spending to increase 40 percent under his watch and has backed tens of billions more in borrowing, mostly for construction projects, that will leave the state paying down debt for decades to come.

California's fragile fiscal state has been evident in how far it has fallen in one year. Twelve months ago, Schwarzenegger claimed to have accomplished the seminal task voters charged him with. He said he had wiped out the state's chronic deficit, which was projected to peak at \$16.5 billion the year he took office.

"Our net operating deficit has been reduced to zero," Schwarzenegger proclaimed last January.

Even before Schwarzenegger signed the current year's budget last summer, however, the gap had reappeared and the expected shortfall for the budget year beginning this July had grown to \$6 billion.

By late last year, as the scope of the housing market bust came into focus, the state's independent legislative analyst estimated the shortfall had swelled to \$10 billion over the next 18 months.

Later this week, Schwarzenegger will announce the estimated shortfall has ballooned to more than \$14 billion — roughly 10 percent of the this year's total spending plan.

"There was a lot of talk (by the governor) of cutting up the state's credit card, and it looked like a one-time fix that was going to work," said Ryan Ratcliff, economist with the Anderson Forecast at the University of California, Los Angeles, referring to bonds and a borrowing limit the governor persuaded voters to approve in 2004.

"But it basically assumed the economy was going to keep growing like gangbusters, and that was going to cover the sins of the past."

Ratcliff said the governor's budget reforms to date have largely been gimmicks.

"They made it look like we addressed the problem, but it was really smoke and mirrors," he said. "Most of the underlying issues still exist."

H.D. Palmer, spokesman for Schwarzenegger's Department of Finance, disputed that account. He said the governor has made real improvements that will force California to deal with its latest budget problems head-on.

"He has taken away a lot of the tools that have been used as balancing ploys in the past," Palmer said.

For example, he said the state is no longer allowed to borrow money indefinitely from transportation accounts and cannot shift tax money away from local governments to cover its own shortfall.

Still, the state's biggest fiscal impediments remain.

As it has under previous administrations, California continues to suffer from boom-or-bust revenue cycles and voter-approved ballot measures that have taken much of the budgeting authority out of the hands of lawmakers.

The state relies heavily on taxes on its richest residents, which can swing wildly from year to year with rising and falling capital gains and stock option revenue.

California's history of governing through the ballot box also has tied lawmakers' hands when times get tight. Spending formulas mandated by voter-approved ballot measures dictate how the governor and Legislature allocate nearly three-fourths of California's tax revenue.

The Legislature's requirement to pass its annual spending plan with a two-thirds majority also has led to a situation in which lawmakers tend to solve fiscal crises by borrowing.

The Democratic majority refuses to cut programs, while Republicans oppose new taxes. By default, borrowing becomes the least objectionable option.

Schwarzenegger has cited such structural problems in calling for more sweeping budget reforms.

In 2005, he pushed a ballot measure he dubbed the "Live Within Our Means Act," which voters rejected along with other measures opposed by unions. The measure would have capped annual state spending growth.

Mike Genest, the governor's finance director, said the latest budget crisis offers a new chance for reform.

"Other states have a process to automatically reduce spending when revenue lags. That is exactly what California needs. The governor has tried budget reform twice before. The Legislature and the people weren't ready to go along," Genest said last week in the governor's weekly radio address.

Schwarzenegger's budgets, however, haven't always been about reforms or spending cuts.

In his first budget in 2004, Schwarzenegger promised to force California to spend only what it took in. He then proposed a \$99 billion plan that relied on a mix of the same kind of borrowing and one-time solutions that led him to criticize former Gov. Gray Davis.

The state still owes \$8 billion on bonds Schwarzenegger convinced voters to approve to balance that year's budget.

In 2006, facing an uncertain re-election, Schwarzenegger proposed using a \$9.2 billion tax windfall to pay for additional spending on schools, roads and health care. The spending exacerbated California's current deficit.

"We've taken on new obligations — and not to say they're not needed — but new obligations without a way to pay for them, and the end result is an unbalanced budget," said Jean Ross, executive director of the California Budget Project, which advocates for funding for the poor. "I think (Schwarzenegger) came in and realized what looks like it ought to be easy, is actually much harder."